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December 8, 1958

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Lawton B. Chandler, Secretary  
State Tax Commission  
State House  
Concord, New Hampshire

OCT 01 1998  
CONCORD, N.H.

Dear Mr. Chandler:

You have recently referred to us for our comments a letter addressed to your Division of Interest and Dividends by Prentice-Hall, Inc., under date of November 7, 1958 in which inquiry is made concerning the position of The State of New Hampshire with respect to Subchapter S which was added to the Federal Internal Revenue Code by the Technical Amendments Act of 1958. Matter explanatory of the Subchapter is attached to your correspondent's letter, and from this it appears that the effect of the new legislation is to give stockholders of certain small business corporations an election to be taxed substantially as partnerships. This is effectuated, it is explained, by permitting the stockholders in a qualifying corporation to include ratably in their incomes the corporation's undistributed income for the years in which a valid election is in effect. The corporation itself is not taxed with respect to such income.

Prentice-Hall furnished a questionnaire in printed form in which specific information is sought. In view of the peculiar nature of our tax upon incomes, the form is quite inappropriate. We cannot suggest how you can fill it out in conformity with its tenor. Rather, the State's position under our statutes must be explained at length.

We believe that the new federal law can have no effect upon the taxation by The State of New Hampshire of the income involved; and that there is no authority vested in the Commission which would permit you to adopt a method of assessing and collecting the tax in such a way as to reflect the effect of the adoption of the election available under Subchapter S by a qualifying corporation.

GENERAL  
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Mr. Lawton B. Chandler -- 2.  
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New Hampshire has no general income tax. The only income taxable by this State is that received as income and dividends (RSA 77). The Interest and Dividends Tax is assessed against only certain classes of recipients (RSA 77:3). Corporations are omitted from the list of taxable recipients. Thus, not only are corporations in common with other taxpayers here free from a general income tax, but they are also not subject to the limited form of income tax in effect with respect to others in New Hampshire.

That which is taxable is set in RSA 77:4. It comprises, broadly, three forms of income: interest, corporate dividends (except stock dividends), and dividends other than stock dividends on shares in partnerships, associations and trusts, the beneficial interest in which is represented by transferable shares. A further statutory provision (RSA 77:7) exempts distributions of capital from the tax, "but accumulated profits shall not be regarded as capital."

RSA 77:3 designates taxable recipients as follows: resident individuals; partnerships, associations, and trusts, the beneficial interest in which is not represented by transferable shares; and fiduciaries deriving their appointment from a court in this State.

Our statute, then, leaves little latitude for administrative adjustment. The matter to be taxed, and the taxpayers, are identified with clarity. If there be income, if it be of the taxable class, and if the taxpayers are, too, within the taxable categories, the tax will be exacted. Otherwise it will not be.

While not professing a full understanding of the treatment of income with respect to the qualifying corporation and its stockholders under Subchapter S, we would suggest that merely regarding under the Subchapter the income of the corporation as that of the stockholders for federal income tax purposes would not constitute such income actually to be dividends. The income, as we understand it, still runs to and belongs to the corporation. At some time in the future it may be distributed to the stockholders as dividends - or as "accumulated profits" (RSA 77:7, supra).

At that time it will be subject to the New Hampshire tax on dividends.

The letter which you forwarded to us is returned herewith.

Very truly yours,

Warren E. Waters  
Deputy Attorney General

Encl.

cc: Council of State Government